

SHOULD LEGAL RULES FAVOR THE POOR? CLARIFYING THE ROLE OF LEGAL RULES AND THE INCOME TAX IN REDISTRIBUTING INCOME

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ABSTRACT

In our 1994 article in this *Journal*, we demonstrated that legal rules should not be adjusted to disfavor the rich and favor the poor in order to redistribute income, because the income tax and transfer system is a more efficient means of redistribution. In this article, we revisit our argument and others that favor relying on the income tax system to redistribute income, and we then focus on qualifications to our argument that we previously offered. In particular, we elaborate on a qualification that is the subject of Chris Sanchirico's article in this issue of the *Journal* and explain why it has only a tangential bearing on the question whether legal rules should favor the poor and why it is of doubtful practical importance.

IN prior articles, we demonstrated in a natural model that legal rules should not be adjusted to favor the poor in order to further redistributive objectives.¹ The reason is that the income tax and transfer system is a superior instrument for redistributing income. We concluded that this result, combined with considerations outside our model, suggests that normative economic analysis of legal rules should focus on their efficiency.

We also noted that, if various of the assumptions in our model are relaxed, it is possible that certain adjustments to legal rules would enhance the efficiency of the income tax in redistributing income. But this would come about in a very indirect manner, and, importantly, there is no a priori

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¹ See Steven Shavell, A Note on Efficiency vs. Distributional Equity in Legal Rulemaking: Should Distributional Equity Matter Given Optimal Income Taxation? 71 *Am. Econ. Ass'n Papers & Proc.* 414 (1981); Louis Kaplow & Steven Shavell, Why the Legal System Is Less Efficient than the Income Tax in Redistributing Income, 23 *J. Legal Stud.* 667 (1994). Essentially the same argument, in the context of discussing the use of distributive weights in cost-benefit analysis, appears in Aanund Hylland & Richard Zeckhauser, Distributional Objectives Should Affect Taxes but Not Program Choice or Design, 81 *Scand. J. Econ.* 264 (1979).

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reason to expect the called-for modifications of legal rules to be pro-poor—the adjustments could just as easily be pro-rich. Because the qualifications to our argument are of a refined nature, are in some respects theoretical curiosities, and in any case are unrelated to the common understanding about the possible use of legal rules to redistribute income, we expressed the view that the qualifications did not alter our basic conclusion in a significant way.

In his article in this *Journal*, Chris Sanchirico revisits some of the qualifications to our result.² Although his analysis is not inconsistent with ours, we believe his interpretation to be misleading and unwarranted, for essentially the reasons just mentioned. In what follows, we restate the central question at issue, discuss our main conclusion, and then turn to qualifications.

I. THE BASIC QUESTION

Should legal rules be adjusted so as to favor the poor, on account of a desire to improve the distribution of income? Suppose, for example, that a policy analyst is considering what tort damages rule should apply to accidents in which yachts owned exclusively by the rich collide with small fishing boats owned by fishermen with low incomes.³ The analyst will conclude for familiar reasons that, under the efficient legal rule—that which minimizes the total of accident costs and prevention costs—damages should equal harm. But, if damages are raised somewhat, the incentives of rich yacht owners to take precautions might be distorted only slightly, whereas the distribution of income might be favorably affected because the fishermen would receive higher payments from the rich yacht owners. Should the analyst therefore endorse such an inefficient legal rule because it redistributes income from the rich to those whose incomes are low? Our impression is that many legal academics have long believed, and, we suspect, still believe, that legal rules should be chosen partly on the basis of their direct redistributive effects, so that in the case we pose they would favor some upward adjustment to the level of damages.

There is, however, a basic problem with the view that legal rules should be modified to favor the poor: society can instead use the income tax system (here interpreted to include programs that transfer income to the poor) to redistribute income. The availability of this simple but central alternative instrument for redistributing income has been ignored by many analysts

² See Chris William Sanchirico, *Taxes versus Legal Rules as Instruments for Equity: A More Equitable View*, in this issue, at 797.

³ For simplicity, we ignore the point that the incidence of a legal rule may be on fishermen's customers (who, on average, we could similarly assume to have lower incomes than rich yacht owners).

who have addressed the question whether legal rules should be selected on distributive grounds.

Moreover, the income tax system possesses several clear advantages over legal rules as a means of redistribution. Notably, the income tax system affects the entire population and, by its nature, treats individuals on the basis of their income. By contrast, the influence of legal rules often is confined to the small fraction of individuals who find themselves involved in legal disputes. Also, legal rules often are very imprecise tools for redistribution because there tends to be substantial income variation within groups of plaintiffs and groups of defendants (so that much redistribution will be in the wrong direction). Additionally, many legal rules—such as those of contract, corporate, and commercial law—often leave the distribution of income essentially unchanged because price adjustments negate the distributive effects of the legal rules.

Setting to the side the above considerations in favor of the income tax, some analysts have advanced what at first may seem to be a plausible argument in support of some use of legal rules as a means of redistributing income. Their argument begins with the observation that using the income tax to redistribute income distorts work incentives, so society will stop short of its distributive ideal because of the inefficiencies involved in the process of redistribution. Thus, the argument proceeds, we should use legal rules to help bridge the redistributive gap. It is admitted that adjusting legal rules to favor the poor will also involve some inefficiency, but there is no particular reason to believe that the inefficiency caused by legal rules will exceed the distortion of work incentives caused by the income tax. Hence, the argument concludes, pro-poor, anti-rich legal rules may well have an important role to play in redistributing income.

In our prior writing—a 1981 article by one of us and a 1994 joint article in this *Journal*—we have explained that there is a fundamental flaw in the foregoing argument concerning the relative efficiency of the income tax and of legal rules in redistributing income.⁴ The mistake in the argument, in essence, is the failure to recognize that if legal rules disadvantage high-income individuals and help low-income individuals, that will tend to discourage work effort in the same manner and to the same extent as making the income tax system more redistributive. Whether it is the tax collector or the courts that take an additional 1 percent of rich people's income and give it to the poor, the reward for work by the rich is reduced by 1 percent, so the distortion of work effort will be the same. However, when inefficient legal rules are employed to redistribute income, there is not only a distor-

⁴ Shavell, *supra* note 1; Kaplow & Shavell, *supra* note 1.

tion of work effort; there is also the cost directly associated with the inefficiency of the legal rule (such as insufficient or excessive precaution to avoid accidents).⁵

In our 1994 article, we developed this argument through a numerical example, a more extended graphical presentation, and a formal model. Although we confined ourselves to simple cases, we explained that the results were general in a number of respects.⁶ And in another paper that we cited, then in progress and subsequently published, one of us has presented formally and proved a much more general version of the argument.⁷ On the

⁵ As some readers may be aware, it is invalid simply to count the number of distortions to determine which approach toward redistribution is more efficient. As Joseph Stiglitz notes, "counting the number of distortions is no way to do welfare analysis." Joseph E. Stiglitz, Pareto Efficient and Optimal Taxation and the New New Welfare Economics, in 2 Handbook of Public Economics 991, 1023 (Alan J. Auerbach & Martin Feldstein eds. 1987). The reason is that one distortion may offset another. (See the example we give in Section II.) Nevertheless, when one approach entails an additional distortion that does *not* offset preexisting distortions, then the approach that includes the additional distortion is less efficient. In the present case, this is true, and this is what we proved in our prior papers. Indeed, this sort of result is familiar in the optimal income tax literature. In concluding his survey of this literature, Stiglitz emphasizes that, even though "traditional arguments against commodity and interest income taxation . . . based on counting the number of distortions . . . are not persuasive," the theory shows that, "in the central case of separability, no commodity taxes should be imposed," which is to say that one should not make otherwise inefficient adjustments in other policy instruments in an attempt to improve redistribution through the income tax. *Id.* at 1037. See also *id.* at 1023 (the view that it would be optimal to supplement the income tax with other policy instruments because "by doing so we impose less of a burden on the income tax . . . seems persuasive . . . but unfortunately is incorrect").

⁶ See Kaplow & Shavell, *supra* note 1, at 679.

⁷ See Louis Kaplow, Should the Government's Allocation Branch Be Concerned about the Distortionary Cost of Taxation and Distributive Effects? (Discussion Paper No. 137, Harvard Law Sch. Program Law & Econ. 1993), cited in Kaplow & Shavell, *supra* note 1, at 667 n.3, 681 n.26, subsequently published as Louis Kaplow, The Optimal Supply of Public Goods and the Distortionary Cost of Taxation, 49 Nat'l Tax J. 513 (1996). (This paper did not focus on legal rules, but the analysis used, as is apparent in the discussion of externalities, see Kaplow, Optimal Supply, *supra*, at 523–24 & n.33, is applicable and the formal analysis is more general than that in Kaplow & Shavell, *supra* note 1.)

Nevertheless, Sanchirico gives the reader the impression that our results are limited in many ways. See Sanchirico, *supra* note 2, at 799 (asserting that our argument that inefficient legal rules cause an additional distortion holds "only when damages are made a function of the parties' income"); *id.* at 814 (describing four assumptions we make and stating that eliminating any of them would produce results contrary to our original conclusion). In advancing his views, however, he makes no reference to the contrary explanation that appears in our 1994 article, see Kaplow & Shavell, *supra* note 1, at 679 (remark entitled "Generality of the result"), or to the formal proof in Kaplow, Optimal Supply, *supra*, at 530–32, which demonstrates that many of his claims are false. (As we emphasize in Section II, some of our assumptions are indeed relevant to our argument, and we discussed such assumptions in our articles.) We also note that some of Sanchirico's statements about the limited nature of various arguments run contrary to what is well known in the optimal income tax literature. (Useful general references include Stiglitz, *supra* note 5 (cited in Kaplow & Shavell, *supra* note 1, at 680 n.25), and Matti Tuomala, Optimal Income Tax and Redistribution (1990).)

basis of this argument and the others noted above concerning the relative advantage of using the income tax system rather than legal rules to redistribute income, we suggested that it made sense “for economic analysis of legal rules to focus on efficiency.”⁸

II. GENERAL QUALIFICATIONS

Does it follow from our argument about the relative efficiency of using the income tax system versus legal rules to redistribute income that, outside of the model we studied, it is *never* the case that one would want to make *any sort of adjustment* to legal rules to attempt, in some subtle way, to improve the ability of the government to redistribute income? Of course not. If one relaxes certain of our assumptions, it is possible that legal rules could have an indirect role in improving the efficiency of redistribution accomplished through the income tax.

Indeed, in our 1994 article, we included a short section on qualifications to our result.⁹ In particular, we described briefly what is considered in the pertinent optimal tax literature to be the most notable qualification to the argument for relying exclusively on the income tax. This concerns situations in which changes in incentives to engage in a nonwork activity influence the distortion of work incentives created by the income tax. In that case, a tax or a subsidy on the activity might enhance the efficiency of the income tax in redistributing income. And, in the absence of such a tax or a subsidy, some adjustment to legal rules might be in order.

To understand this argument, consider again the example involving yachting. Suppose that yachting, because it is very time intensive, is complementary to leisure. That is, the more attractive is yachting, the more attractive it is for the rich to have more leisure time available to devote to yachting. Now, consider the effect of a legal rule that disadvantages yacht owners, say by imposing additional damages when yachts cause accidents. Such a legal rule makes yachting somewhat less attractive and, accordingly, makes leisure somewhat less attractive for the rich. This effect on the labor-leisure trade-off of the rich, however, must be examined against the background of the redistributive income tax that is already in place. Because the

⁸ Kaplow & Shavell, *supra* note 1, at 677.

⁹ *Id.* at 680–81. Most of the ideas contained in our discussions of qualifications here and that we will offer in Section III concerning those that Sanchirico examines have (like Sanchirico’s basic analysis) been familiar in the optimal income tax literature for decades, as we acknowledged explicitly in *id.* at 680 & n.25. (The reader should note, however, that the argument that we present in Section I does *not* depend on there being an optimal income tax in place, which stands in contrast to the optimal income tax literature and Sanchirico’s article.)

income tax applies to income but not to leisure, the effect of the income tax is, as we said earlier, to distort work incentives, that is, to distort the labor-leisure choice in the direction of too much leisure. But, as just explained, the anti-yachting legal rule tends to reduce the amount of leisure that the rich choose to enjoy. Hence, this legal rule will offset somewhat the preexisting distortion caused by the income tax. When all is said and done, this indirect effect of the anti-yachting legal rule makes it possible to adjust the income tax in a manner that accomplishes more redistribution for a given efficiency cost. Thus, the effect of modifying the seemingly efficient legal rule of setting damages equal to harm by raising damages, so as to discourage yachting, would be socially desirable, because the resulting improvement in the incentive to work makes the income tax a more effective tool for income redistribution.

How should one view the import of the sort of qualification just described for our basic argument that it tends to be inefficient to fashion legal rules to favor the poor? In our 1994 article, we said the following: “Such [non-income-tax adjustments], however, are not conventionally redistributive: whether an activity should be penalized or subsidized depends on how the activity affects the labor-leisure choice, not on whether it is undertaken disproportionately by the rich. Thus, although a complete and sophisticated analysis does not demonstrate that it could never be efficient to change legal rules from what narrowly seem to be the most efficient ones, there is no general argument for adjustments of a conventionally redistributive type.”¹⁰

In the present example, the desirable adjustment to legal rules—raising damages paid by yacht owners—happens to be anti-rich. This, however, was a mere coincidence, having to do with our choice of example. If we had considered an activity that is a time saver for the rich, perhaps private jet travel to vacation spots, rather than a time user, then the desirable adjustment in legal rules might well have been pro-rich, by the reasoning given above.

These two examples together make the point that the called-for adjustments are not systematically anti-rich or pro-rich.¹¹ Rather, the direction and magnitude of any adjustment to legal rules depends on the interrelationship between the activity and the labor-leisure distortion caused by the income

¹⁰ *Id.* at 681.

¹¹ Nor does the nature of the adjustment depend on whether an activity is engaged in mostly by individuals who are rich or mostly by individuals who are poor. We could just as easily have examined whether liability rules should be relatively harsh or lenient with respect to libraries or amusement parks. For example, if libraries make leisure more attractive, making library use less attractive (such as by imposing harsher liability rules in association with library use) would reduce the inefficiency of the income tax, and this is true even if libraries are used equally by individuals at all income levels.

tax. Moreover, the redistribution is still done through the income tax; the purpose of the adjustments to legal rules is to enhance the efficiency of the income tax in performing its redistributive function.

We also observed in our prior discussion that, even when the type of qualification under discussion is applicable, it would typically be best not to modify legal rules but rather to adjust excise taxes on the activity in question.¹² In our example, an excise tax on yachting would generally be more efficient than modifying legal rules, thereby restoring our conclusion from the basic model that it is inefficient to use legal rules (here, in a more refined, indirect way) to further the redistributive enterprise.

Because the relevant qualification involves issues that are tangential to the central question that we understood to be on most readers' minds—should legal rules be modified to favor the poor, to disfavor the rich?—and because of other reasons already mentioned and that we consider below, we did not devote a great deal of attention to the qualification and others like it.¹³ Nevertheless, our 1994 article both recognized such qualifications and examined their relevance to our main argument.

III. FURTHER QUALIFICATIONS

A. Analysis

In an attempt to be more complete, we referred, in a footnote in our 1994 article, to another article by one of us with regard to additional qualifications, such as heterogeneity among individuals¹⁴—qualifications that are generally familiar in the literature on optimal income taxation (even though economists in that field have not treated them as particularly significant). It is here that the article by Chris Sanchirico relates to our work. Sanchirico suggests that some of these other possible qualifications—notably, pertaining to heterogeneity in the ability to take care—might make it optimal to adjust legal rules in a manner that departs from what would otherwise

¹² *Id.* at 681. For our more general discussion of excise taxes, see *id.* at 679–80.

¹³ For these reasons, our discussion appeared in an appendix, but it was not difficult to locate given the brevity of our article, the use of a clearly labeled separate section (*id.* at 680–81), and our announcement in the text of our main section that qualifications would be discussed in the appendix (see *id.* at 669). Moreover, our conclusions were stated in a manner consistent with our qualifications. See *id.* at 675 (arguments taken together “*suggest* that normative economic analysis of legal rules should be *primarily* concerned with efficiency” (emphasis added)); *id.* at 677 (concluding that the analysis “*suggests* that it is appropriate for economic analysis of legal rules to *focus* on efficiency” (emphasis added)).

¹⁴ See Kaplow & Shavell, *supra* note 1, at 681 n.3, citing Kaplow, Should the Government's Allocation Branch, *supra* note 7, “[f]or discussion of other qualifications.”

seem efficient. Such adjustments, in a direction favorable to the “less well-off,” he suggests, would enhance the “equity” of the overall system.¹⁵

As should be apparent from our discussion of qualifications in Section II and in our 1994 article, we believe Sanchirico’s claim that our basic argument is subject to certain qualifications is correct but does not go to the heart of whether legal rules should be systematically adjusted to favor the poor and disfavor the rich in order to further distributive objectives.¹⁶ The easiest way to see this is to explore Sanchirico’s argument in two simple cases.

First, suppose that everyone is rich (equally so) and enjoys yachting. It turns out, however, that some are klutzier than others, and klutzes are more likely to cause accidents. In addition, klutzes are worse off than everyone else in other respects as well: they more often spill their champagne so as to stain their Oriental rugs, damage their Rolls Royces by backing into lamp-posts, and so forth. Should damages imposed on yacht owners equal harm in this example? Following Sanchirico’s analysis, the answer is negative: damages should be less than harm. Why? Because the klutzy rich are “less well-off” and they would benefit from such an adjustment since they are more likely to be defendants than their more coordinated peers. (The reader should note that “less well-off” in Sanchirico’s paper *does not refer to those with lower income*¹⁷—in our example, where his logic is fully applicable, all have the same income—but rather to those who may be less well-off for reasons independent of their income—here, klutziness.) This example demonstrates a simple point: introducing heterogeneity with regard to skill in taking care may indeed favor a departure from the seemingly efficient legal rule, but in a manner that is unrelated to whether the favored party is richer or poorer than the disfavored party.¹⁸

¹⁵ See, for example, Sanchirico, *supra* note 2, at 797 (abstract).

¹⁶ Sanchirico does not acknowledge the existence of our qualifications section (the one section of our article that is directly relevant to his), see Kaplow & Shavell, *supra* note 1, at 680–81, does not mention that we obviously are aware of the specific qualifications that are the subject of his article, see the citation in note 14 *supra*, and does not discuss any of the points we raise in our prior articles concerning the implications of such qualifications.

¹⁷ In some instances it might, but by coincidence. Our point is simply that the reason Sanchirico uses the language of more and less well-off (and, corresponding, “equity” rather than income equality) is that his analysis pertains to factors other than income; in a particular instance, those less well-off may tend to be those with lower income, but in others, they will be those with higher income, and in others still, who is less well-off will be unrelated to income, as our discussion in the text demonstrates. To be sure, Sanchirico tends to present examples in which the less well-off are the poor, which may create a contrary impression, but the reader should keep in mind that his examples, like ours, are just examples. (Also, as we discuss in note 23 *infra*, Sanchirico’s examples in which adjustments to legal rules favor those with lower income usually rely on assumptions that are implausible, even the opposite of what is likely to hold in reality.)

¹⁸ The reader may wonder about the underlying reason that links a phenomenon like klutziness to adjustments of legal rules. The argument here depends on the following points:

Second, suppose as in our original example that only yacht owners are rich and that their victims are the low-income fishing boat owners rather than other rich yacht owners. Does Sanchirico's argument now favor raising damages, so as to redistribute from the rich yacht owners to fishermen? No. *In fact, Sanchirico's argument has the opposite implication, that the legal rule should be adjusted to favor rich yacht owners and disfavor low-income fishermen.* Why? For exactly the reason stated in the preceding example: a pro-defendant adjustment helps klutzier yacht owners, who are less well-off than their peers (rich yacht owners who are not klutzes). What about the low-income fishing boat owners? Well, when making all of the necessary adjustments toward optimality, including to the income tax, one would be taking the situation of low-income individuals into account. In particular, as we describe in our 1994 article, one could simultaneously make the income tax more redistributive to compensate the fishing boat owners for receiving lower damage payments. The net effect of the two adjustments—making the legal rule favor yacht owners and the income tax more redistributive—would be to keep the distribution between fishing boat owners and yacht owners the same, while, within the group of rich yacht owners, helping the klutzes at the expense of others.¹⁹

Taken together, we believe that these examples establish that the adjustments Sanchirico advances, in favor of the “less well-off” to enhance “equity,” are qualitatively different from the adjustments that we suspect most

klutzes are generally worse off than everyone else; because of this, we wish to help klutzes; and, importantly, we are unable to observe who the klutzes are, so we cannot assist them directly, such as by reducing their income taxes. In this situation, we may want to adjust how we respond to certain events, like accidents. (This would equally include yacht accidents giving rise to tort claims, accidental spills causing rug stains, and accidental damage to Rolls Royces.) Because klutzes are more accident-prone, those involved in accidents are more likely to be klutzes than randomly selected rich people. Hence, adjusting legal rules (and the prices charged by rug cleaners and Rolls Royce repair shops) to favor those who cause accidents will tend to have a favorable equity effect, on average helping klutzes whom we cannot help directly (because we cannot identify who they are).

The importance of unobservability of klutziness is reinforced by considering a different case: people who are blind. Because the blind can be identified, it is possible to assist them directly, by lowering their income taxes or otherwise. Only if we could not tell who was blind would we need to resort to indirect (less well targeted and less efficient) means of assisting them, such as adjusting legal rules.

¹⁹ This point is obscured in Sanchirico's paper. In his longer, verbal exposition, he does not make the income tax adjustment (except briefly when presenting, in a footnote, what he describes as a different case (see Sanchirico, *supra* note 2, at 800 n.6)), which would seem to undermine his argument. Likewise, he ignores the point that his proposed adjustments of legal rules would, in general, affect labor effort. It turns out, however, that the effects of these two omissions cancel out when one does the mathematics because Sanchirico confines his analysis to the case where the income tax system is set optimally with regard to the trade-off between redistribution and efficiency. In our prior articles and here we emphasize the tax adjustment both for clarity and because our own analysis applies even when the income tax system is *not* set optimally.

legal academics have in mind when they talk about adjusting legal rules to favor the poor. We emphasize this point because, although Sanchirico's article does not literally contradict our claim—notably, he never insists that the less well-off are necessarily the poor and he remarks that various matters “go only to the direction of the proper equity adjustment” (suggesting that either direction of adjustment is possible)²⁰—we are concerned that readers may not have appreciated the true meaning that lies behind his statements.²¹

Our two examples raise the question whether one could generate examples in which the adjustments to legal rules would in fact be pro-poor. The answer is clearly in the affirmative. The most straightforward case is simply to reverse our example with regard to which types of people are klutzes. That is, suppose that rich yacht owners are all of the greatest dexterity, whereas some fishing boat owners are klutzes. In this case, favoring klutzes means favoring plaintiffs (low-income fishing boat owners) over defendants (rich yacht owners). Thus, a rule favoring the “less well-off” in Sanchirico's sense could indeed involve favoring parties with relatively low income. A priori, who will be favored (what will be the direction of the equity adjustment) will depend on whether there is greater klutziness among yacht owners or among fishing boat owners. This rather refined question, of course, is quite different from whether yacht owners or fishing boat owners are richer.

²⁰ Sanchirico, *supra* note 2, at 797 (from abstract, emphasis omitted); see also *id.* at 805–6, 807.

²¹ We have this concern in part because Sanchirico frequently refers to adjustments favoring the “less well-off,” without highlighting the fact that (as in the two examples we just presented), these may be the rich (but individuals who, among the rich, may be less well-off). The only explicit statement we could identify in his article appears in a footnote that follows a technical discussion. There he states: “Note that it is *theoretically possible* that the optimally redistributive manner of conditioning legal rules on income will turn out to favor parties with more income.” *Id.* at 800 n.6 (emphasis added). We do not understand the basis for relegating this a priori equally plausible case to a single footnote and describing it as a mere theoretical possibility when the opposite case—for which he offers not even a plausible empirical conjecture in a single example (see note 23 *infra*)—is treated in the remainder of the article as the one that should be the basis for readers' understanding of reality.

In addition, in the one proposition that he offers that refers explicitly to income, the conclusion concerns when damages should favor “low-income individuals” under certain conditions. Sanchirico, *supra* note 2, at 819. He does not explicitly mention that, under other conditions, damages should favor high-income individuals. Moreover, he does not tell the reader that this really is just a single example, and that one could just as easily (as we do in the text) construct examples where the adjustment would favor high-income individuals. (Indeed, in this very example, more realistic assumptions would plausibly change his result. See note 23 *infra*.)

Also, in his conclusion, he suggests that an important fact “would affect *how*, but not *whether*, the tort system should be used for redistributive purposes” (*id.* at 820), but he does not explain to the reader that the “*how*” may just as well involve adjusting legal rules to favor the rich as to favor the poor.

In his own argument, Sanchirico uses a construction that is based on the idea just presented. In particular, he considers the possibility that the degree of klutziness is correlated, positively or negatively, with income-earning ability. In such a setting, one would begin an inquiry about optimal adjustments to legal rules by asking in which group would we expect to see more klutzes, among rich yacht owners (who labor on Wall Street and dash off to their vacation home on summer weekends to try their hand at the helm) or fishing boat owners (for whom manual dexterity is necessary to make a living)?

To begin with, let us assume that there are more rich klutzes than working-class klutzes—that is, that klutziness and income-earning ability are positively correlated.²² Now, as our above discussion suggests, this is a case in which legal rules should favor the rich yacht owners, for the Sanchirico “equity” adjustment favors the group in which klutziness is more prevalent. Of course, had we supposed instead—as Sanchirico does in most of his discussion²³—that rich people are more dexterous, whereas the fish-

²² Sanchirico refers not to klutziness, but to skill in avoiding accidents (anti-klutziness). Skill in avoiding accidents and income-earning ability are negatively correlated in the present example.

²³ See Sanchirico, *supra* note 2, at 801. Sanchirico supports this conjecture by suggesting that different types of abilities tend to be positively correlated. That is, he claims that the skills that make one able to generate riches in the market will tend to make one less accident-prone in other endeavors. As our discussion in the text suggests, however, in a modern economy, in which those with greater income-generating potential will tend to develop their mental skills, the opposite conjecture may be more plausible. There is, moreover, another respect in which the opposite case, with which we begin, seems more likely: care often involves *time*, and time has a greater opportunity cost (by definition) for those who earn higher wages. Thus, if some sort of care takes an hour of effort, the opportunity cost for a \$400-per-hour law firm partner is 20 times higher than the opportunity cost for a \$20-per-hour blue-collar worker. (Hence, only if the law firm partner were more than 20 times more efficient in the use of time to reduce accidents would Sanchirico’s featured case occur.) We also note that, in many realistic cases, the cost of care will (as in many simple economic models) be the same for everyone. For example, the cost of a new light bulb for one’s turn signal will not depend on one’s income (abstracting from the time required to make the replacement).

Another way that Sanchirico generates a construction in which the adjustment is unfavorable to the rich is to consider a case in which the rich may be klutzier (because unobservable klutziness is positively correlated with unobservable income-earning capacity) and in which the rich and poor engage in the activity to the same extent (in our example, we would thus be considering a case in which the rich and poor pilot yachts equally often). *Id.* at 819. In such a case, those who are defendants are disproportionately klutzes, who are also disproportionately high-income-earning-*ability* individuals and are also disproportionately rich. Though the optimal adjustment would ignore that defendants are disproportionately rich (because high income per se is best addressed by adjusting the income tax) and would tend to favor the rich defendants because they are disproportionately klutzy (as we explained in the text above), an anti-rich adjustment would be advantageous because the defendants are disproportionately of high income-earning *ability*, because this is correlated with klutziness. Now, if this latter factor is more important than the pro-klutz factor, the net effect would be to favor a rule that was anti-rich. This is one of the methods by which Sanchirico gives the impression that the adjustments called for by his analysis will tend to favor low-income people. Of course, in reality, the main reason that a particular group of defendants (say, yacht

ing boat owners are more likely to be klutzes, then one obtains the result that the legal rule should be modified to disfavor the rich yacht owners.

Thus, when we consider Sanchirico's actual model and argument, involving possible correlations between klutziness and income-earning ability, we again see that the optimal adjustments to legal rules have no general, a priori relationship to the notion that legal rules should favor the poor in order to further redistributive objectives. Again, whether there should be any adjustment—and the direction of the adjustment (pro-rich or anti-rich)—depends on subtleties about factors distinct from those that are usually on our minds when we think about income redistribution.

B. *Practical Implications*

From our preceding discussion, it is clear that the sorts of adjustments to legal rules that Sanchirico contemplates in the name of equity are qualitatively different from the changes that one would make if the guiding principle were to alter legal rules in a manner that, on its face, appeared to favor the poor. We now consider briefly whether one should and could, as a practical matter, make these sorts of subtle adjustments.

We begin by observing that Sanchirico's paper gives little guidance in this regard. First, he presents no concrete examples²⁴ or evidence that would permit even a reasonable conjecture as to any adjustment of any legal rule that one might make. He nevertheless insists that some adjustment will almost always be better than no adjustment.²⁵ Yet, if one does not know even the *direction* in which to make the adjustment—which is the case here—such advice is of little use. Moreover, even if one knew the direction of the optimal adjustment, doing something is likely to be worse than doing nothing where the optimal adjustment is small. This is true because one may well overshoot the optimum in such a case, possibly causing more harm than good, and because the administrative cost of determining what adjustments to make and of implementing them might dwarf any benefit.

owners) will be disproportionately rich is not that the rich are disproportionately klutzy, but rather because the rich are more likely to engage in the activity. But this is *not* a reason to adjust legal rules in an anti-rich direction, because pure income differences, even when they lead to differences in activity choices, are best addressed by adjusting the income tax. In summary, Sanchirico's construction—which is presented as a proposition in his formal analysis—is actually an involved hypothetical example, and his result is an artifact of using a set of assumptions that, although plausible simplifications for some purposes, combine in the present instance to produce an impression concerning the direction of the proper adjustment that may well be the opposite of what would be optimal in reality.

²⁴ In saying this, we do not interpret as a concrete example his (in our view, implausible; see note 23 *supra*) statements of assumptions that are offered in the course of his more abstract discussion.

²⁵ See Sanchirico, *supra* note 2, at 810.

Second, although Sanchirico calls for empirical research to provide guidance, the research program he contemplates is problematic. In his informal discussion, he mentions a number of inquiries that could be made, and in his formal analytical discussion, he identifies what one would need to measure to determine the proper adjustment. The problem, however, is that there is little overlap between the two discussions. The adjustments depend on correlations between two presumed-to-be-unobservable types of ability,²⁶ whereas the data he mentions concern largely unrelated matters.²⁷ To be precise, the correlation one needs to measure is between unobservable income-earning *ability* (as distinct from income actually earned) and the underlying *skill* of individuals in avoiding accidents (as distinct from whether individuals were careless in particular instances in which accidents occurred). As should be apparent, it will not be easy to design a research program that would provide reliable measures of such a correlation.

We do not wish to be unduly dismissive of Sanchirico's suggestion that empirical work be undertaken. Empirical analysis is generally helpful, and one cannot know the answers to empirical questions without evidence. Nevertheless, there are a number of reasons to be skeptical. First, as noted, Sanchirico fails to offer any sound empirical conjectures and, despite his detailed attention to the issue, does not state clearly how one might improve our existing state of knowledge. This does not inspire confidence in the likely success of empirical investigation.

Second, the capacity of legal policy analysts to do empirical research is limited. Given how little empirical work has been done on the most basic features of the legal system, such as on the effect of myriad types of legal rules in controlling the behavior that they address, it would seem to be a mistake to allocate significant effort toward a refined question where the prospects of success appear to be dim.

Third, we note that the qualifications under discussion have been understood by public finance economists for decades. Despite substantial empirical efforts to explore matters bearing on the distortionary costs of taxation,

²⁶ As Sanchirico correctly explains, it is important that these types of ability are not observable, for if they were, one could take them into account directly in designing the income tax and legal rules, and the sorts of adjustments he examines would be unnecessary. See also our discussion in note 18 *supra*.

²⁷ Sanchirico suggests an analogy to insurance companies' use of demographic information in setting premiums. See Sanchirico, *supra* note 2, at 809–10. But, of course, the demographic information (such as age) is observable, and, likewise, insured events (such as death, in the case of life insurance) are observable. Hence, his analogy is irrelevant for present purposes. He also suggests that courts in different jurisdictions might experiment in order to determine the responsiveness of individuals to legal rules. *Id.* at 809. But clearly these behavioral effects do not directly illuminate either of the two unobservable phenomena at issue, much less the correlation between them.

these qualifications have received little attention.²⁸ We suspect that the reason is, in large part, a combination of the belief that they often are not very important and the recognition that it would be difficult to shed light on them through empirical work.²⁹

Finally, we observe that, if the various qualifications that we and other researchers have noted—including the one Sanchirico examines—do turn out to be important, their relevance will primarily concern broader adjustments to government policy than just tinkering with legal rules. And, as we noted above with regard to excise taxes, if the most appropriate policy adjustments are made, it may well be optimal to leave legal rules untouched in any event.

IV. CONCLUSION

Our prior writing and this article address the basic question whether legal rules should be adjusted to favor the poor. Our main argument is that such use of legal rules to redistribute income is generally less effective than relying exclusively on the income tax system to achieve distributive objectives. Combined with more familiar arguments concerning the shortcomings of using legal rules to redistribute income, we continue to suggest that normative economic analysis of legal rules focus on their efficiency.³⁰

In our 1994 article, we recognized that there were qualifications to our argument concerning the relative efficiency of using the income tax versus legal rules to redistribute income. But, as we noted there and have elaborated here, these qualifications involve subtle refinements that are tangential

²⁸ A recent exception concerns the issue of activities that are leisure substitutes or complements, the qualification that we discussed in our 1994 article and in Section II. See Aled Ab Iorwerth & John Whalley, *Meals on Wheels: Restaurant and Home Meal Production and the Exemption of Food from Sales and Value Added Taxes* (Working Paper No. 6653, Nat'l Bur. Econ. Res. 1998).

²⁹ An additional reason for inattention may be that positive results from such investigation would not be taken seriously by policy makers. For example, suppose that a greater percentage of yacht owners than fishing boat owners are klutzes. Do we believe that policy makers—whether in the legislature or in the courts—would be likely to adjust legal rules on this account—that is, to favor rich yacht owners because of the subtle reasons indicating that such an outcome promotes equity? (Sanchirico offers a competing conjecture: that scholars tend to study what is old because there is more to study. See Sanchirico, *supra* note 2, at 809. But basic legal rules are a good deal older than modern tax and transfer schemes, so this hardly appears to be the reason for inattention to the subtle effects of legal rules.)

³⁰ We do not consider here arguments about institutional responsibility or politics that may bear on the desirability of using legal rules to redistribute income, matters that we discussed briefly in Kaplow & Shavell, *supra* note 1, at 675, and in Kaplow, *Optimal Supply*, *supra* note 7, at 520–21. Nor do we address administrative costs, which would seem to be an important factor that weighs against using legal rules to attempt to redistribute *significant* amounts of income. In addition, we do not consider various other qualifications that are explored in other literature.

to the ordinary view concerning how legal rules might be adjusted to increase redistribution, namely, to favor the poor at the expense of the rich. As we explained, the adjustments called for if various of the qualifications, including that discussed by Sanchirico, turn out to be important are not what one might have expected; in particular, the optimal adjustments to legal rules may well be ones that favor the rich. Moreover, although one or another qualification may turn out to be relevant in some instances, we would need to have sufficient evidence (or, at minimum, plausible empirical conjectures) in order to know what, if any, adjustments to legal rules should be made. Yet, as we have explained, the relevant information does not seem likely to be forthcoming.

The purpose of this comment has been to clarify our original argument and these qualifications, both of which can be elusive. Sanchirico's abstract exploration of one of our qualifications does not, unfortunately, illuminate the empirical question and, more important, does not in our opinion provide any basis for modification of our prior conclusion concerning the proper emphasis of normative economic analysis of legal rules.